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C O N F I D E N T I A L SECTION 01 OF 03 KUWAIT 001879

SIPDIS

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SUBJECT: KUWAIT INVESTMENT AUTHORITY: DOING FINE BUT
WATCHING U.S. MARKET EXPOSURE CLOSELY

Classified By: Ambassador Richard LeBaron for reason 1.4 (d)

11. (C) Summary: During a May 3 meeting with the Ambassador, Kuwait Investment Authority Managing Director Bader Al-Sa'ad said that KIA's assets had grown "substantially" over the previous year, but noted that recently KIA's U.S. investments had been a "drag on overall performance." He also said that KIA was selling real estate holdings in the U.S. because of "high taxes on capital gains and income." He said that the annual contributions to the Kuwait Future Generations Fund, which is managed by KIA, is not as large as is commonly thought because of the recent massive increase in GOK expenditures. Comment: The KIA is thought to manage amounts between \$75 and \$100 billion on behalf of the GOK but maintains a very modest outward appearance, both physically and in the amount of information it makes available to the markets and its own citizens. End Summary and Comment.

KIA: History and Background

12. (C) Ambassador met with Kuwait Investment Authority (KIA) Managing Director Bader Al-Sa'ad and Head of the Americas Investment Department Ahmad Bastaki on May 3 in order to learn more about KIA's investments in the U.S. and elsewhere. KIA was founded in 1982 and is charged with managing the investments of the GOK. The source of these investments come from two major areas: the Future Generations Fund (FGF), which is a 10% set-aside from government revenues each year, and all other surpluses in the general reserves. The two categories are managed separately and the funds are not co-mingled. KIA does not publicly disclose its total assets, but it is thought to control between \$75 and \$100 billion. It allocates these assets into investments in OECD countries, based roughly on each country's percent of total world GDP, according to Al-Sa'ad. The U.S. and some European countries have received a larger share of investments than their GDP indicates, he added.

13. (U) KIA is overseen by a Board consisting of the Finance Minister as Chairman, the Minister of Energy, the Central Bank Governor, a Ministry of Finance Undersecretary, and five other Kuwaiti nationals with backgrounds in investment and finance. The Board appoints a Managing Director to oversee the day-to-day operations. KIA has over 300 employees in Kuwait and also operates an office in London. The London operation, known as the Kuwait Investment Office, actually predates KIA's charter, having been established in 1953. According to Al-Sa'ad, the KIO is considered by the Government of the UK to be similar to a "financial attach" and is accorded "special treatment" by the City of London. Additional background on the KIA can be found at:
<http://www.kia.gov.kw>.

A "Good Year", But Concerns Over U.S. Economy

14. (C) Al-Sa'ad said that the past year had been good for KIA, and that its assets grew "substantially." He expressed concern over the performance of assets in OECD markets, in which he said the KIA was "heavily exposed." He said that the KIA "does not really hedge against downturning markets," and added that the "U.S. is really dragging" on the performance of KIA's assets. KIA's investments in the U.S. are mostly in equity funds managed through medium-sized investment firms, Al-Sa'ad explained, adding that KIA uses a variety of third party fund managers to manage its assets. KIA used to own a good deal of property in the U.S., Al-Sa'ad said, but was having to sell these holdings because of what he described as "high taxes on capital gains, income and dividends." He attributed these tax difficulties to the absence of a Double Taxation Treaty between the U.S. and Kuwait. KIA has a wholly owned subsidiary in the U.S., "Breadstreet Inc.", that manages its remaining property holdings, Al-Sa'ad said, and still invests in real estate through real estate investment trusts (REITs) and other mechanisms. He said that the KIA was still actively looking for ways that the GOK could continue to own property in the U.S.

15. (C) Al-Sa'ad noted that the contributions from the budget into the Future Generations Fund (FGF) were not as large in the past year as some thought because of the rapidly expanding GOK budget. With all of the big projects that the GOK is planning, he explained, there was less surplus revenue

to be given to KIA. The "mega-projects" he mentioned included the planned causeway across Kuwait Bay, the Bubiyan Port, Failaka Island, railway projects and more. He also said that the GOK was increasing its expenditures on infrastructure maintenance and that this was also using up funds that would otherwise go to the KIA.

Keeping A Low Profile, but Answering to Parliament

16. (C) When the Ambassador noted the modesty of Al-Sa'ad's office compared to the lavish offices of other top financial executives in Kuwait and especially relative to the amount of money that KIA handles, Al-Sa'ad responded that KIA is still a government body and still needs to answer to the National Assembly on its own internal budget. (He pointed out that he has been waiting for a new carpet for his office for over a year. It needs it.) He explained that the KIA is regulated by the State Audit Bureau and has to report annually to the National Assembly, which reviews its internal budget and the performance of the assets under its management. Any MP is entitled to look at KIA's budget, he said, and is entitled to know the total amount of assets under KIA management. This review usually takes place in June or July, he explained, and the Kuwaiti newspapers usually publish general points and a rough estimate of KIA's assets at that time. Al-Sa'ad would not disclose the amount of KIA assets, but did say that the newspaper discussions of the budget hearings would give a rough idea.

Not Investing in the GCC, Some Investments in Kuwait

17. (C) When asked about regional investments, Al-Sa'ad said that the KIA was not heavily invested in GCC countries, and only had a few small holdings and interests in things "purchased years ago." While noting that the current economic growth throughout the GCC is "a good boom," he said that it was really all the same area and economic climate as Kuwait and that the KIA did not see the need to invest in the whole GCC if it could make some investments in Kuwait. It would be a duplicate investment, he explained, and would also duplicate the risk and KIA's exposure in the region. The GCC doesn't need capital, he added, and said that the KIA "does not want to compete with private sector investment." The KIA has some investments in Kuwait, Al-Sa'ad said, including a 20% stake in Bubiyan Bank, a newly formed Islamic bank. He said the KIA prefers to let the private sector make these types of investments in Kuwait, but that the bank investment was a unique situation. The Central Bank had received almost 20 separate applications from Kuwaiti banks and financial institutions to open an Islamic bank, he explained, so instead of having to choose amongst them, the Central Bank asked KIA to provide some capital to start a new bank and then allowed the public to buy a stake. He said the KIA will eventually sell its stake.

Funds Flows Back to Kuwait

18. (C) When asked his opinion about flows of private capital, Al-Sa'ad said that it appeared that money was coming back to Kuwait from being invested abroad, but he added that he could not be sure of the mix of incoming funds. He said that the most obvious sign that money was coming back to Kuwait from abroad was the continued rise of the stock market and real estate prices, despite the fact that the Central Bank has consistently raised the interest rates and capped bank lending over the past year.

Not Ready to Invest in Iraq

19. (C) The Ambassador encouraged Al-Sa'ad to direct KIA assets towards Iraq to help spur economic growth. Al-Sa'ad agreed that there would be strong opportunities for investment in Iraq in the future. In the present, however, Al-Sa'ad said that it was still too risky for KIA to make investments there and that there were many questions to be answered, including when the market there would be opened up, how it would look and when Iraq would really join the international economic community. He said that he thought that Iraq could be an "anchor for the region" in terms of economic growth and development. Comparing the GOK's method of investing its oil surplus through the KIA with any future oil surplus investment system in Iraq, Al-Sa'ad said that there would be many more opportunities for viable internal investments in Iraq than there were in Kuwait and that future governing bodies in Iraq would not need to look abroad as much as the GOK does for investment opportunities. He did, however, agree that the method Kuwait uses for managing its oil revenues may have some relevance for Iraq as it wrestles with this difficult issue.

Bio Note

10. (C) Bader M. Al-Sa'ad was appointed as Managing Director of the Kuwait Investment Authority in December, 2003. He has worked in the investment and financial sector for 24 years and is a graduate of Kuwait University with a major in Accounting. He speaks good English.

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